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89-1059

In the
Supreme Court of the United States
October Term, 1989

ALBERT J. DeANGELIS, *Petitioner,*

vs.

SECURITIES AND EXCHANGE COMMISSION, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Whether a not a tippee may be held liable under the anti-fraud provisions of the Securities and Exchange Act of 1934 as amended and under the rules promulgated by the Commission, Section 10 (b), 15 U.S.C. 78(j)(b) and Rule 10b-5, 17 C.F.R. 240.10b-5, where there was no showing that he acted with scienter or that he knew or should have known that the information provided to him by an alleged subsequent tipper was misappropriated by a twice removed and unknown to him primary tipper in breach a fiduciary duty to his employer?

2. Whether or not a tippee may be held liable under the Securities and Exchange Act of 1934 as amended and under the rules promulgated by the Commission, Section 14 (e), 15 U.S.C. 78(n) (e) and Rule 14e-3, 17 C.F.R. 240.14e-3, for trading in options and stock where there was no showing that he knew or should have known that he was in possession of material, non-public information about pending tender offers imparted by the "offering person" or someone acting on his behalf?

3. Whether or not the remedy of a permanent injunction against future violations of the Securities Laws is improvident where no persistent pattern of violation of the law is demonstrated nor does it appear that future violations of law are likely to result in the absence of such injunctive relief?

4. Whether or not the remedy of retroactive disgorgement of profits plus pre-judgment interest is an equitable remedy where the delay in prosecution of the case is not attributable to the petitioner, there is insufficient proof of scienter and the very nature of the trades made them highly speculative, the risks were extremely high and the tippee's risk of loss was greater than his chance of gain, despite the eventual outcome which was shown to be predicated upon chance rather than upon market manipulation or the use of deceptive devices?

PARTIES

The defendant-appellant in the United States Court of Appeals for the Second Circuit was ALBERT J. DeANGELIS. The plaintiff-appellee in the United States Court of Appeals for the Second Circuit was the Securities and Exchange Commission.

TABLE OF AUTHORITIES

Cases:

Bateman, Eichler, Hill, Richards, Inc. v. Berner, et al., 472 U.S. 299 (1985) 10

Dirks v. SEC, 463 U.S. 646 (1983) 11

SEC v. National Securities, Inc., et al., 393 U.S. 453 (1969) 10

SEC v. Switzer, et al., 590 F. Supp 756 (W.D. Okla. 1984) 11

Statutes and Rules:

15 U.S.C. 78(j)(b) i, 2, 3

15 U.S.C. 78(n) (e) i, 2, 4

Rule 10b-5, 17 C.F.R. 240.10b-5 i, 2, 3

Rule 14e-3, 17 C.F.R. 240.14e-3 i, 2, 4, 5

28 U.S.C. Section 1254(1) 2

TABLE OF CONTENTS

QUESTIONS PRESENTED i

PARTIES ii

TABLE OF AUTHORITIES iii

JURISDICTIONAL STATEMENT 2

STATUTORY PROVISIONS INVOLVED 3

STATEMENT OF THE CASE 5

REASONS FOR GRANTING THE PETITION.

I. THE PETITION SHOULD BE GRANTED BECAUSE THIS CASE PRESENTS IMPORTANT ISSUES FOR THIS COURT'S REVIEW CONCERNING THE APPLICATION OF THE CIVIL ENFORCEMENT PROVISIONS OF THE FEDERAL SECURITIES LAWS AND BECAUSE THE OPINIONS BELOW REPRESENT A JUDICIAL EXPANSION OF THE LAW BEYOND ITS INTENDED REACH, LEGISLATIVE INTENT AND THIS COURT'S PRIOR DECISIONS . 9

CONCLUSION 13

APPENDIX

No.

In the

SUPREME COURT OF THE UNITED STATES

October Term, 1989

ALBERT J. DeANGELIS,

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vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ALBERT DeANGELIS (DeANGELIS) respectfully petitions this Court to issue a Writ of Certiorari to review an order issued February 22, 1990 by the United States Court of Appeals for the Second Circuit (Second Circuit) (A. 1, 2).[1] The Second Circuit affirmed a judgment entered by the United States District Court, Southern District of New York substantially for

1. Refers to appendix attached hereto.

the reasons relied upon by the District Court in a civil proceeding alleging insider trading and naming nine defendants, including DeANGELIS. The Court held DeANGELIS liable for violation of Section 10(b) and Section 14(e) of the Securities and Exchange Act, 15 U.S.C. 78(j)(b), 78 (n) (e), Rule 10b-5, 17 C.F.R. 240.10b-5, Rule 14e-3, 17 C.F.R. 240.14e-3 for trading in securities, ordered DeANGELIS to disgorge profits, and to pay pre-judgment interest on the disgorged profits. In addition, the Court entered an order permanently enjoining further violations of the federal securities laws (A. 3-29).

OPINIONS BELOW

On August 8, 1989, the United States District Court, Southern District of New York entered an order determining the civil action brought by the SEC against DeANGELIS, the sole remaining defendant in the case. (A. 3-A.29)

On February 22, 1990, the United States Court of Appeals for the Second Circuit entered a summary order affirming the judgment substantially upon the opinion of the District Court (A. 1-2)

JURISDICTIONAL STATEMENT

This petition seeks review of an order of the United States Court of Appeals for the Second Circuit, rendered February 22, 1990. The present petition was filed within 90 days of that date. This petition is timely in accordance with the rules of this Court.

The jurisdiction of this Court is invoked pursuant to Title 28 U.S.C. § 1254 (1).

STATUTORY PROVISIONS INVOLVED

1. Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. 78j(b) provides that:

[i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange ...

(b) [t]o use or employ, in connection with the purchase or sale of any security, registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2. Rule lOb-5, 17 C.F.R. 240.10b-5 provides that:

> [i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) [t]o employ any device, scheme, or artifice to defraud,
>
> (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under they were made, not misleading, or
>
> (c) [t]o engage in any act, practice or course of

> business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

3. Section 14(e) of the Securities and Exchange Act of 1934, 15 U.S.C. Section 78n(e), provides:

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitations for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

4. Rule 14e-3, 17 C.F.R. 240.14e-3 provides in relevant part:

> (a) If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14 (e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is non-public and which he knows or has reason to know has been acquired directly or indirectly from:
>
> (1) [t]he offering person,
>
> (2) [t]he issuer,of the securities sought or to be sought by

such tender offer, or

(3) [a]ny officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.

STATEMENT OF THE CASE

On January 12, 1983, the Securities and Exchange Commission (SEC) commenced a civil action in the United States District Court, Southern District of New York against nine defendants, including DeANGELIS. The complaint alleged violation of various provisions of the Securities and Exchange Act of 1934 and of the rules promulgated by the Commissioner pursuant thereto. The complaint related to trading in stocks and options in the years 1981 and 1982. Related criminal charges involving insider trading were commenced against some of the defendants, including DeANGELIS. The criminal case against petitioner was *nolle prosequied* in May of 1985. Prior to the trial in this action in the year 1988, the civil proceeding was concluded with respect to all of the defendants except DeANGELIS by the entry of judgments either on consent or by the Court and by discontinuance upon the death of defendant Musella in the year 1984.

A non-jury trial was conducted before the Hon. Kimba Wood, United States District Judge, Southern District of New York on February 27, February 28 and March 1, 1989. On August 8, 1989, the District Court rendered its opinion. The Court found that although neither DeANGELIS or his alleged

tipper knew the source of the information concerning stocks and trades in publicly traded companies, that DeANGELIS was responsible for violation of Section 10(b) and 14(e) of the Securities and Exchange Act and of related rules. The District Court premised liability upon the conclusion that DeANGELIS should have known that he was trading upon misappropriated non-public information stolen from a New York law firm concerning matters involving its clients (A. 15, 18-23) and that with respect to trading in Marathon Oil Options and Penn Central Stock (A. 23-26), that DeANGELIS should have known that he was in possession of non-public material information concerning a proposed tender offer, which information was imparted by the offering person or someone acting on its behalf.

The record before the District Court shows that DeANGELIS, unsophisticated as a trader, had previously invested in the stock market. With respect to the trades at issue in this case, he discussed the various speculation opportunities with his long-term friend Dominick Musella, who died in a car accident in 1984 prior to the trial in this matter. Musella owned a beauty salon in Brooklyn, New York and it was shown that he had never invested in the stock market prior to the trades involved in this case. The record shows DeANGELIS had no relation to nor did he know of Alan Ihne, an employee of the law firm of Sullivan & Cromwell, who later admitted to the willful misappropriation of confidential information concerning mergers and acquisitions involving the firm's clients in the year 1981 or 1982. The information stolen by Ihne consisted of a list of company names without dates that listed one company in the first column and another company in the second column. The information was provided by Ihne to his friend Joseph Palomba and to James Stivaletti, Palomba's stockbroker. Ihne, Palomba and Stivaletti conspired together to make stock and call option purchases based upon this information. Securities involving Texasgulf, Inc. were traded by the three conspirators under Palomba's name. Thereafter, Palomba expressed concern over the use of his own account to purchase securities on behalf of

the group. Stivaletti enlisted Dominick Musella, the brother of a college classmate, to purchase securities for the group (A. 5). Stivaletti did not reveal Musella's identity to either Ihne or Palomba. Although Musella pressed Stivaletti to tell him the source of his information, Stivaletti refused to reveal the name of the source, the nature of that person's occupation and the identity of his employer or of the originator of the information (A. 6).

On August 13, 1981, Musella, who never before engaged the services of a stock broker and who had never before invested in the stock market, purchased 4000 shares of Garfinckel stock for $136,791.37. The next day a tender offer for Garfinckel shares was announced by Allied Stores Corporation, a client of Sullivan and Cromwell. Musella sold his shares and realized a net profit of $51, 566.76. Thereafter, Musella, acting upon the instructions of stock broker Stivaletti, purchased certain call options in Marathon Oil on October 29, 1981 for $76,844.79, selling those options on November 2, 11 and 19 for $649,339.89. On October 22, 1981, Musella purchased 9000 shares of Penn Central stock, again acting upon the instructions of Stivaletti. He sold those shares on November 5, 1981. On February 22, 1982 and February 25, 1982, Musella purchased 14,000 shares of Signode Corporation for $66,582.27. After Signode's announcement of a leveraged buyout and instructions from Stivaletti, Musella sold his Signode shares, realizing a profit of $95, 246.63. The record shows that DeANGELIS was not in any way involved in the trades engaged in by or the profits that accrued to Musella.

On October 29, 1981, DeANGELIS purchased, for his own account, 120 December 70 options in Marathon Oil for $64,000 and he purchased 3,000 shares of Penn Central stock for $120,742,44 on November 2, and November 3, 1981. Between February 9, 1982 and February 25, 1982, appellant purchased 12, 700 shares of Signode stock for $518, 886.33. Petitioner testified at trial that he had discussed purchase of

options in Marathon Oil and purchase of stock in Penn Central and Signode with his friend Dominick Musella. Musella advised DeANGELIS of his own intention to make investments in those securities and made him aware of the fact that he had recently realized a substantial profit by investment in Garfinckel stock. In making his investment decisions, DeANGELIS was influenced by articles and public reports concerning Marathon Oil and Penn Central and Signode Corporation, by the recommendations of his friend Musella and by Musella's recent success in speculative trades.

The District Court found that DeANGELIS violated the federal securities laws by trading in Penn Central and in Signode stock and by trading in Marathon Oil options. Even though the record shows that DeANGELIS could not have had actual or even constructive knowledge of the source of the tips passed on to him by his friend Musella, the District Court opined that he should have known that he was trading on non-public information. There was nothing in the record to indicate that DeANGELIS acted with scienter. The District Court premised its finding of violation of the securities law upon the theory that DeANGELIS consciously avoided finding out the source of the information. It is submitted that this theory was inapplicable to the case at bar in light of the District Court's acknowledgement that DeANGELIS's alleged tipper Musella did not know and was unable to find out the source of the information (A. 6). It follows that if the alleged tipper could not find out the source of the information, the person he was imparting the information to was in no position to find out the source of the information and conscious avoidance on the part of DeANGELIS should not be found here. In addition, the District Court credited testimony from an SEC investigator that he remembered a telephone conversation held more than seven years prior to trial in which DeANGELIS denied knowing Musella as providing proof of scienter. This information was not in the investigator's notes nor did it tend to prove that DeANGELIS knew or should have known that he was trading on misappropriated non-public

information stolen by an employee of the law firm of Sullivan & Cromwell in breach of fiduciary duty.

The District Court found the information was misappropriated by an employee of Sullivan & Cromwell in breach of fiduciary duty to his employer. Further, the Court found that with respect to Marathon and Penn Central, DeANGELIS should have known that the information about those companies was non-public, material and imparted by an entity proposing or contemplating a tender offer, or someone acting on its behalf. The District Court and the Second Circuit broadly interpreted the federal securities laws. The Courts' rulings effectively make a twice removed from the source tippee as responsible as a primary tippee for trading in stocks or call options where the record shows he did not know and could not determine the source of the information, had no way to determine the source was violating a fiduciary duty to an employer and had no way to determine that the rumor of a proposed tender offer was in fact being imparted by the entity proposing the tender offer or someone acting on its behalf.

REASONS FOR GRANTING THE PETITION.

I. THE PETITION SHOULD BE GRANTED BECAUSE THIS CASE PRESENTS IMPORTANT ISSUES FOR THIS COURT'S REVIEW CONCERNING THE APPLICATION OF THE CIVIL ENFORCEMENT PROVISIONS OF THE FEDERAL SECURITIES LAWS AND BECAUSE THE OPINIONS BELOW REPRESENT A JUDICIAL EXPANSION OF THE LAW BEYOND ITS INTENDED REACH, LEGISLATIVE INTENT AND THIS COURT'S PRIOR DECISIONS .

It is respectfully submitted that the petition should be granted because of the important issues presented as to the

application of the enforcement provisions of the federal securities laws. See *SEC v. National Securities, Inc., et al.*, 393 U.S. 453 (1969) (Petition for Certiorari granted because of importance of questions raised to administration of securities laws); *Dirks v. SEC*, 463 U.S. 646 (1983) (Petition for Certiorari granted in view of the importance to the SEC and to the securities industry of the questions presented).

The lower Courts expansive interpretation of the reach of the law to make a subsequent tippee liable where it was shown that he had no connection whatsoever with the primary tippee or of the primary tipper, did not know and did he have the ability to find out the source of the information, where the source was employed or the nature of the source's occupation or that the information was obtained via a violation of fiduciary duty to an employer, threatens the viability of the market by imposing an extraordinary and burdensome investigative duty upon persons wishing to trade in stocks or call options. In this case, DeANGELIS relied upon the speculative successes and the recommendations of his friend Musella and upon his own evaluation of public reports in reaching a decision to make security purchases in the three companies, Marathon, Penn Central and Signode. The record is devoid of any showing that DeANGELIS knew that the information was appropriated, non-public information obtained in breach of a fiduciary duty. Further, with respect to the call options in Marathon and Penn Central, DeANGELIS neither knew or had the ability to find out that the information was material, non-public information imparted by a proposed tender offeror or its agent.

In *Bateman, Eichler, Hill , Richards, Inc. v. Berner, et al.*, 472 U.S. 299, (1985), this Court observed that a tippee cannot be said to be as culpable as the tipper whose breach of duty gave rise to the tippee's liability in the first place. Here, DeAngelis was a subsequent tippee who should be found to be substantially less culpable than a tippeewho was in privity with the tipper. DeANGELIS was not shown in the record to have

any direct connection at all with the tipper.

In *Dirks v. SEC,* 463 U.S. 646 (1983), this Court construed Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 less expansively then the interpretation given by the District Court in this case. In *Dirks, this* Court found that a duty to disclose or abstain from trading on the part of a corporate insider does not arise merely from a showing that he possesses non-public market information. It must also be shown that the insider violated his fiduciary duty to the corporation so as to realize a personal benefit.

In the case *sub judice* , DeANGELIS, not an insider and owing no fiduciary duty to the corporations involved, was effectively held liable under the provisions of Section 10(b) and Rule 10b-5 because the District Court found he possessed non-public market information. In addition, the District Court premised liability under Section 14e-3 and Rule 14e-3 upon its conjecture that DeANGELIS had reason to know that tips concerning Marathon Oil and Penn Central call options were derived from the proposed tender offerer or its agent. Yet, the record shows with clarity that the tender-offeror or its agent were entities and individuals whom DeANGELIS did not know, know of or have any connection with whatsoever. Premising liability upon a tippee equal to or as broad as that of the tipper is inconsistent with the provisions of the federal securities laws and this Court holding in *Bateman* that the duty and culpability of the tippee is less than that of the tipper.

In *SEC v. Switzer et al.*, 590 F. Supp 756 (W.D. Okla. 1984) the Court strictly construed Section 10(b) and Rule 10b-5 as pertains to tippees in accordance with this Court's decision in *Dirks* . It was held that even if it had been shown that the corporate insider disseminated material, non-public information for an improper purpose, the defendants did not know and did not have reason to know of the materiality of the information, its non-public nature or that it was given by a corporate insider for

an improper purpose.

In the case *sub judice* , nothing in the record suggests that DeANGELIS knew or had reason to know of the materiality of the information, its non-public nature or that it was imparted by an insider for an improper purpose. DeANGELIS had no connection of any sort with Ihne, the tipper and the employee of Sullivan & Cromwell. DeANGELIS did not know who Ihne was or what he did. Nor could he have known that Ihne imparted the information for an improper purpose, to wit: to benefit himself financially.

It is submitted that this petition should be granted because this case presents issues involving the uniform application of the Securities and Exchange Act of 1934 and the Rules adopted by the Commissioner pursuant thereto and the standard of conduct of persons trading in securities. In addition, this case presents an important issue concerning the use of the Court's injunctive powers to enjoin future violations of law, where there is no indication that the legal remedies are likely to be ineffective in deterring or preventing future violations. Further, the petition should be granted here for there is a strong likelihood that the decision below will have a chilling effect on speculative market investment, which constitutes a substantial portion of the revenues received by the securities industry and provides needed impetus to the Nation's economy.

CONCLUSION

For the foregoing reasons, it is earnestly urged that the petition for a writ of certiorari to review the decision and order of the Second Circuit should be granted, along with such other and further relief awarded to petitioner as this Court may deem just and proper.

Dated: Brooklyn, New York
May 21, 1990

Respectfully submitted,

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APPENDIX-TABLE OF CONTENTS

PAGE

Order of the United States Court of Appeals, Second Circuit, dated February 22, 1990 — A. 1

Order of the United States District Court, Southern District of New York dated August 8, 1989 — A.3

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 22nd day of February one thousand nine hundred and ninety.

Present:

HONORABLE J. EDWARD LOMBARD
HONORABLE RICHARD J. CARDAMONE
HONORABLE RALPH K. WINTER
Circuit Judges,

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,

V.

DOMINICK MUSELLA, ALBERT J. DEANGELIS,ANTHONY BRUNETTI, THOMAS DISPIGNO, RICHARD ROSENKRANZ, JOHN MUSELLA, VITO ROSSINI, EDWARD O'NEIL and RICHARD B. MARTIN,
Defendants,

ALBERT J. DEANGELIS,
Defendant-Appellant.

Filed February 22, 1990

ORDER

Docket No. 89-6235

Albert J. DeAngelis appeals from a judgment of

the United States District Court for the Southern District of New York (Wood, J.) entered September 28, 1989. The court found appellant had violated sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), 78n(e), Rule 1Ob-5, 17 C.F.R. 240.10b-5 and Rule 14e3, 17 C.F.R. 240.14e-3. Appellant was ordered to disgorge profits obtained in the underlying transactions and to pay prejudgment interest on the disgorged profits, and was enjoined from further violations of the federal securities laws.

We affirm substantially for the reasons stated in Judge Wood's thorough opinion filed August 9, 1989.

The judgment of the district court is affirmed.

s/
J. Edward Lumbard, U.S.C.J.

s/
Richard J. Cardamone, U.S.C.J.

s/
Ralph K. Winter, U.S.C.J.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
----------X

SECURITIES AND EXCHANGE COMMISSION

Plaintiff,

-against-

DOMINICK MUSELLA, ALBERT J. DEANGELIS, ANTHONY BRUNETTI, THOMAS DISPIGNO, RICHARD T. ROSENKRANZ, JOHN MUSELLA, VITO ROSSINI, EDWARD O'NEILL and RICHARD B. MARTIN,

Defendants.
----------X

83 CV 342 (KMW)

OPINION

WOOD, D.J.

This is an insider trading case brought by the Securities and Exchange Commission (the "SEC") against several individuals who allegedly purchased securities based on information stolen from the law firm of Sullivan &. Cromwell. A former Sullivan & Cromwell employee and his stock broker, who participated in these illegal activities, pleaded guilty to criminal charges of insider trading and served time in prison; other participants either lost or settled civil claims resulting in disgorgement of profits and injunctions against future trading.[1] The SEC now complains that the sole

[1] see United States v. Ihne et al., S 84 Cr. 686 (CLB);S.E.C. v. Musella et al., 578 F.Supp. 425 (S.D.N.Y.. 1984) (Haight, J.); S.E.C. v. Musella, et al., 678 F.Supp. 1060 (S.D.N.Y. 1988)

defendant remaining in this case, Albert DeAngelis, knowingly purchased securities in three companies based on material, non-public information stolen from Sullivan & Cromwell. Following a three day bench trial, the Court finds that defendant violated the federal securities laws.

I. FINDINGS OF FACT

The following are the Court's findings of fact. The primary tipper in this insider trading scheme was Alan R.Ihne, formerly the manager of the office services department at Sullivan & Cromwell, a New York law firm. Stipulated Fact ("SF") 1. Between January 1, 1981 and December 31, 1982, the period in which. the trades at issue in this suit occurred, Sullivan & Cromwell rendered confidential legal advice to certain clients concerning proposed and anticipated tender offers, mergers, and leveraged buyouts. Sullivan & Cromwell distributed to every employee, including Ihne, a series of memoranda concerning the importance of safeguarding confidential information, and Ihne was aware of the firm's policy. SF 2.

Ihne admits that he knowingly and willfully misappropriated confidential information from Sullivan & Cromwell about corporate mergers and acquisitions involving Sullivan & Cromwell clients. 3; Trial Transcript ("Tr.") at 36. Moreover, Ihne testified that he knew what he was doing was wrong but that he nonetheless made a "conscious decision" to steal the information. Tr. at 36; SF 3.;

Ihne supplied the misappropriated information both to a friend, Joseph Palomba, and to Palomba's stockbroker, James Stivaletti. SF 4. Ihne, Palomba and Stivaletti subsequently formed a three man scheme to profit from the confidential information that Ihne misappropriated from Sullivan & Cromwell. The group agreed that Ihne would steal information

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(Haight, J.); S. E. C. v. Musella, et al, 83 CV 342 (IW), Judgment dated December 9, 1988.

concerning possible tender offers, mergers, or leveraged buyouts from Sullivan & Cromwell and give the information to Stivaletti who would make their investment decisions. SF 5, 7. In furtherance of this scheme, Ihne, Palomba and Stivaletti purchased call options in Texasgulf, Inc. ("Texasgulf") shortly before a tender offer for Texasgulf shares was announced by Societe Nationale Elf Aquitaine, S.A., a client of Sullivan & Cromwell. SF 5, 6.

After the Texasgulf transaction, Palomba expressed concern over the use of his own account to purchase securities on behalf of the group. Ihne and Palomba asked Stivaletti to find someone to purchase securities on the group's behalf. SF 8. Stivaletti enlisted Dominick Musella, the brother of a college classmate, to purchase securities for the group. Musella and Stivaletti initially agreed that if Stivaletti found another "good opportunity like Texasgulf," Musella would buy the stock, and they would divide the profits evenly. Plaintiff's Exhibit (PX) 11 (Affidavit of James Stivaletti) at para. 8; Tr. at 98-102. Stivaletti advised Musella to spread his trading among different accounts, and if possible, different names. Id. at para. 114. Stivaletti reported back to Ihne and Palomba that he had located someone willing to purchase stock for them. Stivaletti did not reveal Musella's identity to Ihne and Palomba, referring to him only as "Tom Jones." PX 11 at para. 110, 12; Tr. at 104-105.

On August 13, 1981, Musella made the first securities purchase of his life. Based on information Ihne had stolen from Sullivan & Cromwell, Ihne and Stivaletti concluded that there was going to be a tender offer for Garfinckel. SF 9. Stivaletti called Musella and gave him instructions to purchase shares of Garfinckel. Stivaletti Aff. at para. 12; Tr. at 99. Upon hearing from Stivaletti, Musella, who did not have a broker, called the Teamsters Union Office in Queens looking for his friend, defendant Albert DeAngelis. DeAngelis was not in, and Musella spoke instead to Richard Stolfi, an official at the union office whom he had met through DeAngelis. Musella asked Stolfi to recommend a broker. Stolfi recommended Gus Drakos at Merrill Lynch. That day,

Musella opened through Drakos the first brokerage account he ever had and purchased 4,000 shares of Garfinckel stock for $136,791.37. SF 10. Musella financed the Garfinckel transaction by cashing a $20,000 certificate of deposit, at a penalty, and with $48,000 borrowed from his then 19 year old nephew, Frank Tumminia. Tumminia's funds represented life insurance proceeds that he had recently received from the death of his parents. Musella had never borrowed money from Tumminia before and did not sign any documents guaranteeing his repayment of the loan. SF 11.

The next day,, August 14, 1981, a tender offer for Garfinckel was announced by Allied Stores Corporation, a client of Sullivan & Cromwell. Musella sold his shares that same day for $188,358.13, realizing a net profit of $51,566.76. SF 12. Shortly after the Garfinckel transaction, Stivaletti arranged to meet Musella in Musella's Cadillac in front of a diner in Bay Ridge, New York. During the meeting, Musella handed Stivaletti an envelope containing approximately $18,000 in cash. Musella asked Stivaletti for the source of his information, but Stivaletti refused to tell him. PX 11 at para. 14; Tr. at 101, 107. As a result, Musella began to refer to Stivaletti's source as "The Goose that Laid the Golden Egg." PX 11 at para. 10, 11; Tr. at 104-105.

A. DeAngelis Purchases Marathon Oil Options

Stivaletti and Ihne next decided to purchase stock in the Marathon Oil Company ("Marathon") based on information Ihne misappropriated from Sullivan & Cromwell. SF. 18, 19, 23. Stivaletti called Musella and told him to purchase Marathon options. Stivaletti gave Musella specific instructions to purchase call options of a certain series and strike price. PX 11 at para. 22; Tr. at 102. Although Musella told Stivaletti he was unable to purchase any Marathon options (PX 11 at para. 23, Tr. at 102), on October 29, 1981, Musella bought 200 December 70 and 100 December 80 call option contracts in Marathon Oil for a purchase price of $76,844.79. Musella sold his options on November 2, 11, and 19, 1981 for a total

selling price of $649,339.89, realizing a net profit of $572,495.10. SF 20. Musella never told Stivaletti that he purchased the Marathon options, and he never shared any of the profits with Stivaletti, Palomba, or Ihne. Tr. at 103.

DeAngelis purchased Marathon call options on October 29, 1981, the same day that Musella purchased Marathon call options. DeAngelis called his broker, Lewis Siegel, at 3:45 p.m. on October 29, 1981 and directed him to purchase 120 December 70 Marathon options at the prevailing market price (these options had the same expiration date and strike price as one of the two types of Marathon options purchased by Musella) Siegel told DeAngelis the options would probably cost $30,000 to $40,000. In fact, the options cost over $64,0004 Siegel testified that when he called DeAngelis back to confirm that he had placed the order, DeAngelis had no reaction upon learning that the options had cost nearly double Siegel's earlier estimate. Tr. at 157-159. DeAngelis called Musella at 4:24 p.m.on the day they both purchased the options. PX 12 (New York Telephone Company Records). DeAngelis sold these options on November 4, 6, and 9, 1981 at a net profit of $268,513.86. SF 21.

DeAngelis' purchase of Marathon options on October 29, 1981 was his first securities transaction since April of 1980. His account had been inactive for 19 months. Tr. at 146-147; PX 25 (Monthly Account Statements from Thomson McKinnon Securities). Prior to buying Marathon options, DeAngelis had purchased options on only two other occasions, both times in 1978. PX 25. In order to pay for the Marathon options, DeAngelis borrowed the money from DeAngelis Jewelers -- a business in which he had no financial interest. A check from DeAngelis Jewelers was issued to Albert DeAngelis on October 30, 1981 in the amount of $62,801.18. SF 22; Tr. at 205.

DeAngelis testified that he bought Marathon because "I know he (Musella] was buying it, and two, I felt like taking a gamble." Tr. at 243. He testified that he thought he would make money on Marathon because "I had been hearing

different conversations about oil stocks, and oil was the game in town at that time." Tr. at 244. DeAngelis further claimed that he was interested in Marathon because he read about the company in "foreign newspapers," and more specifically, in an "Australian publication." Id. at 261, 327. DeAngelis did not produce any of these articles at trial. Finally, DeAngelis testified at his deposition that he purchased Marathon because he made money on Penn Central and knew the government would take his profit in taxes if he did not make another purchase. Id. at 267.

Musella confirmed that he spoke with DeAngelis about Marathon. Musella testified that "Mr. DeAngelis expressed great interest in also purchasing Marathon options," and that he and DeAngelis agreed that "it was beneficial to buy (Marathon) options rather than common stock." PX 6 at 154.

B. DeAngelis Purchases Penn Central

In late October of 1981, Stivaletti concluded from a document Ihne had taken from Sullivan & Cromwell that a tender offer for Penn Central was imminent. SF 15. Ihne and Stivaletti agreed to contact "Tom Jones" (Musella) to direct a purchase of Penn Central stock. Stivaletti then contacted Musella and directed him to buy Penn Central stock. PX 11 at para. 18; Tr. at 106-107.

Musella purchased 9,000 shares of Penn Central on October 22, 1981. He sold these shares on November 5,1981. SF 16. DeAngelis purchased 1,000 shares of Penn Central on November 2, 1981 and 2,000 shares on November 3, for a total purchase price of $120,742.44. DeAngelis sold these shares on November 9, 1981 for a profit of $4,661.33. SF 17.

DeAngelis and Musella had several discussions concerning Penn Central before DeAngelis made his purchases. According to Musella, during these conversations "DeAngelis was expressing to me certain feelings that he had in regards to Penn Central and I (Musella] was expressing my feelings and thoughts that I had about Penn Central...." PX 8

(Deposition of Dominick Musella) at 593; see also Tr. at 210-211, 233.

DeAngelis testified that he purchased Penn Central, because he did a lot of reading on the company and "thought Penn Central was going to be... subsidized like the railroads are in Europe ... [and] if they would sell off the land holdings they had [then the stock] would be worth a lot of money." Tr. at 229-230.

C. DeAngelis' Purchases of Signode Corporation

Ihne also stole confidential information from Sullivan & Cromwell concerning Signode Corporation ("Signode") Tr. at 52-53; SF 26. In February of 1982, while in Hong Kong on vacation, Stivaletti learned about a takeover involving Signode during a telephone conversation with Palomba. Tr. at 109. Stivaletti called Ihne from Hong Kong on February 9, 1982 at 1:45 a.m. (E.S.T.) to confirm that Signode would be acquired. Stivaletti then called Musella at 2:00 a.m. (E.S.T.) to advise him of the Signode takeover. Stivaletti told Musella not to purchase Signode until he returned from Hong Kong because he wanted to do some research on the company. Musella called Stivaletti back twice that day, at 12:47 p.m. (E.S.T.) (lasting 1 minute) and 12:51 p.m. (E.S.T.) (lasting 8 minutes). After his return from Hong Kong, Stivaletti directed Musella to purchase Signode. Tr. at 109-110; PX 11 at para. 26; SF 24.

DeAngelis called Musella on February 9, 1982 at 12:18 P.M. (E.S.T.), 10 hours after Stivaletti had told Musella about the Signode acquisition. The call lasted 19 minutes and 17 seconds. DeAngelis began purchasing Signode that same day, amassing 12,700 shares of Signode between February 9 and February 25, 1982 at a total purchase price of $518,868.33. SF 24, 25.

Musella began purchasing Signode after Stivaletti returned from Hong Kong. Musella purchased 14,000 shares of Signode between February 22 and 25, 1982 for a total purchase price of $664,582.27.

DeAngelis testified that he "definitely ... discussed Signode with Mr. Musella" and that it was he who brought Signode to the attention of Musella. Tr. at 210, 269-270. DeAngelis further testified that he purchased Signode stock because he read an article in a Teamster's booklet about the malfunctioning of strapping materials and believed Signode manufactured a superior product at 210, 269-270. DeAngelis' did not produce the Teamster's article at trial.

DeAngelis also testified that he discussed Signode with John Malizia, the son of a close friend. DeAngelis "strongly recommended" Signode to Malizia as [b]asically a short-term investment . . . because . . . it was a possible takeover possibility . . . " Tr. at 419. Malizia was beginning a side business, called Targa Associates, to invest funds for middle income family members and to provide advice about money market funds. SF 34. Despite having never heard of Signode prior to his conversation with DeAngelis, on February 12, 1982, Malizia (on behalf of Targa Associates) purchased $123,621.43 of Signode stock. The funds were obtained from Malizia's personal assets, as well as from various family members, including parents, uncles and grandparents, whom Malizia told he "had something good." Tr. at 423, 434. Malizia concluded that DeAngelis was getting his information from "people that knew something about what was going on with the particular instruments . . . someone that did know what was happening. " Malizia did not think this information was available to the general public. Tr. at 419, 421-422.

After Signode announced a leveraged buyout, Stivaletti told Musella to sell his Signode shares. Musella sold the shares between March 1 and 2, 1982, realizing a profit of $95,246.63. DeAngelis sold his stock in Signode between March 1 and 3, 1982 at a profit of $89,617.91. SF 25. After selling his Signode shares, Musella gave Stivaletti $4,500 which Stivaletti split with Ihne and Palomba. Tr. at 111; PX 11 at 126. Stivaletti and Ihne both pleaded guilty to criminal charges of insider trading and served time in prison. Palomba pleaded guilty to criminal tax fraud charges relating to his insider trading profits. Tr. at 94; SF 27; PX 26; PX 27.

Dominick Musella, originally a defendant in this action, died in a car crash on June 20, 1984. The SEC abandoned efforts to substitute his estate. Joint Pre-Trial Order at 2.

D. Musella Knowingly Traded On Stolen Confidential Information

The Court finds that Musella knew he was receiving stolen, confidential information from Stivaletti. According to Stivaletti, Musella "candidly understood" that the stock information Stivaletti was giving him was based on material, non-public information. Musella "didn't know where (the information was coming from) but he knew it was non-public information." Tr. at 123. Stivaletti further testified that he told Musella that it was confidential information from a source that he would not identify. Id. at 132-133. Musella gave the source of his inside information a code name: "The Goose that Laid the Golden Egg." IA. at 104-105. After the Garfinckel transaction, Musella asked Stivaletti "if this source was good" and whether "there was going to be another takeover deal." PX 11 at 1 14. During the same time period, Musella told Stivaletti. that if Stivaletti "were able to give him [Musella) a week's notice of a deal, he (Musella] could buy it somewhere else." Stivaletti understood this to mean that Musella could buy stock through an overseas account or in some other place or name. Id. at 119. on one occasion, Musella showed Stivaletti a magazine article about insider trading. The article described different sorts of people who could get access to inside information, including lawyers, secretaries and printers. The article also contained a cartoon depicting the various sources of illegally obtained confidential information. Musella pointed to the cartoon and asked Stivaletti which one of the people depicted was Stivaletti's source. Stivaletti told Musella that "it's one of those." Tr. at 108, 124; PX 11 at %16.

Before he joined the Ihne-Palomba-Stivaletti scheme, Musella had never before purchased securities or had a brokerage account in his life. Moreover, Musella had an extremely limited knowledge of the securities markets. He was

described by one witness as incapable of intelligently discussing the stock market. Tr. at 420 (Testimony of John Malizia). Musella also lacked the financial resources necessary to make large securities purchases. In 1979 and 1980, Musella reported income of $6,642 and $4,361, respectively on his tax returns and stated that he was a beautician and the owner of the "Swirl & Curl" beauty salon in Brooklyn. After joining the Ihne-Palomba-Stivaletti scheme, Musella listed his occupation on his 1981 tax return as "private investor" and his short term capital gains ballooned to $745,662.00. SF 28-30.

Musella invoked his Fifth Amendment privilege against self- incrimination when asked by the SEC if he discussed Texasgulf Garfinckel, Marathon, Penn Central or Signode with Stivaletti. Musella also invoked his Fifth Amendment privilege when asked if he gave anything of value to Stivaletti and when asked to identify and describe all conversations he had with DeAngelis concerning these securities. PX 10 at 712-713, 717.

E. Musella's Relationship with DeAngelis

DeAngelis and Musella met in the late 1950's and became close friends. During the period from August 1981 through the end of 1982, they spoke to each other at least two or three times per week. Tr. at 209, 239-240. DeAngelis testified that they spoke often and "discussed everything ... that two people can discuss," including stocks. SF 31; Tr. at 209, 216, 381.

DeAngelis testified that he and Musella begun discussing the stock market in 1977 or 1978. According to DeAngelis, "[w]e talked about shells, we talked about dividends, we talked about taking control of a company, how much stock to vote, the chairman of the board on the chair (sic), all conversations that would come up. it Tr. at 242. Despite these extensive conversations with Musella, DeAngelis told the Court that he did not know that Musella had never purchased a security in his life until Musella purchased shares of,Garfinckel in August of 1981. DeAngelis was unable to explain to the Court how he discussed securities for over four

years with a man who had never purchased securities in his life. Id. at 376-377.

DeAngelis also testified at trial that he did not know until "reading this case" that he and Musella did business with the same Merrill Lynch broker, Gus Drakos, in Cedarhurst, New York. DeAngelis testified that DeAngelis' son recommended that he open an account with Drakos. at 368-370.

DeAngelis was interviewed by telephone on November 3, 1981 by SEC Investigator Edward Harrington as part of a SEC investigation into suspicious trading in Marathon oil. During the interview, Harrington asked DeAngelis if he knew Dominick Musella, whose trading in Marathon options had also come to Harrington's attention. Harrington testified that DeAngelis told him he did not know Dominick Musella. Tr. at 389. Although defendant claims that Harrington's testimony is "incredible," Defendant's Post-Trial Brief at 18, the Court finds Harrington highly credible.

Following the initial questioning by Harrington, DeAngelis was subpoenaed to appear before the SEC on December 16, 1981 as part of the SEC's investigation into trading in Marathon options. DeAngelis appeared but he refused to testify, invoking his Fifth Amendment privilege. Id. at 161, 360-361.

II. CONCLUSIONS OF LAW [2]

1. DeAngelis Violated Section 10(b) of the Securities Act and Rule 10b-5

To establish that the defendant violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder, the SEC must show that the defendant made

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[2] Any conclusion of law that is a finding of fact should be deemed to be a finding of fact.

improper use of confidential material information in connection with the purchase or sale of securities, and that the defendant acted with scienter.[3] Dirks v. SEC, 463 U.S. 646,

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[3] Section 10(b) provides that:

> [i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange ...
>
> (b) [t]o use or employ, in connection with the purchase or sale of any security, registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 provides that:

> [i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) [t]o employ any device, scheme, or artifice to defraud,
>
> (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under they were made, not misleading, or
>
> (c) [t]o engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

659-660 (1983); United States v. Carpenter, 791 F.2d 1024, 1033-1034 (2d Cir. 1986), aff'd, Carpenter v. United States, 484 U.S. 19 (1987) Aaron v. SEC, 446 U. S. 680, 695 (1980) (scienter requirement).

For purposes of Section 10 (b) and Rule 10b-5, an employee makes improper use of confidential information when he obtains material, non-public information intended to be used only for a proper purpose and uses it in breach of a fiduciary duty or other relationship of trust and confidence to his employer. United States v. Carpenter, 791 F.2d at 1033-1034; Dirks, 463 U.S. at 654.

The requisite, fiduciary duty can be found where the person is an "insider," see, e.g., SEC v. Texas Gulf Sulphur, 401. F.2d 833 (2d Cir. 1968), or a tippee of such a person, Dirks, 463 U.S. at 659, or it can be found where an employee, like Ihne, misappropriates confidential information from his employer and trades on it. See, e.g., SEC v. Carpenter, 791 F.2d at 1024; SEC v. Materia, 745 F.2d 197, 203 (2d Cir. 1984); SEC v. Musella ("Musella I"), 578 F.Supp. 425, 438-439 (S.D.N.Y. 1984). This duty also applies where a tippee, like DeAngelis, trades on such misappropriated information when he knew or should have known it was misappropriated. See, e.g., SEC v. Carpenter, 791 F.2d at 1032; United States v. Newman, 664 F.2d 12, 16-19 (2d Cir. 1981), cert. denied, 464 U.S. 863 (1985); Musella I, 578 F.Supp. at 437-439.

In Newman, two employees of separate investment banking firms misappropriated material, non-public information concerning proposed mergers and acquisitions that had been entrusted to their employers by clients of the firms. The investment banking firm employees tipped this information to defendant Newman, a securities trader, who purchased securities before the information was publicly disseminated and made a substantial profit. This Circuit held

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in connection with the purchase or sale of any security.

that the misappropriation of confidential information by the two investment bank employees and Newman, their tippee, constituted fraud "in connection with" the purchase or sale of a security in violation of Section 10(b) and Rule 10b-5.

> By sullying the reputation of [the investment bankers'] employers as safe repositories of client confidences, appellee and his cohorts defrauded those employers as surely as if they took their money.

Newman, 664 F.2d at 17.

In the opinion for a preliminary injunction in this case, the court (Haight, J.) observed that

[b]y endorsing the alternative "misappropriation" theory of Rule 10b-5 liability [in] Newman ... the Second Circuit gave legal effect to the commonsensical view that trading on the basis of improperly obtained information is fundamentally unfair, and that the distinctions premised on the source of the information undermine the prophylactic intent of the securities laws.

Musella I, 578 F.Supp. at 438. Accord Materia, 745 F.2d at 201; see also United States v. Carpenter, 971 F.2d at 1024 (employee reporter's misappropriation of information regarding articles to appear in The Wall Street Journal and subsequent trading by tippee was a breach of duty to the reporter's employer and a violation of Rule 10b-5).

a. Ihne Breached His Duty to Sullivan & Cromwell by Stealing Confidential Client Information

Ihne owed a duty to Sullivan & Cromwell, his employer, and to clients of Sullivan & Cromwell not to misappropriate material, non-public

information entrusted to him by Sullivan & Cromwell clients. Ihne had an absolute duty not to trade based upon misappropriated confidential client information and not to disclose this information to persons outside Sullivan & Cromwell. See Carpenter, 791 F.2d at 1033-1034; Materia, 745 F.2d at 201202; United States v. Newman, 664 F.2d at 16-19; Musella I, 578 F.Supp. at 439.

Ihne, as Manager of Office Services at Sullivan & Cromwell, knew from repeated office memoranda that his firm had a strict policy requiring that all information learned in connection with employment be kept confidential. Ihne breached his duty when he misappropriated information concerning Sullivan & Cromwell clients and target companies of these clients. See Musella I, 578 F.Supp. at 439.

Stivaletti knew that the information Ihne was giving him was stolen from Sullivan Cromwell in the course of Ihne's employment with the firm. Stivaletti recruited Musella to join the scheme and directed Musella to make trades based on Ihne's misappropriated information.

Although Musella did not know the name of the source of information given to him by Stivaletti, Musella knew that the information was illegally obtained from an inside source. Musella referred to that source as "The Goose Who Laid the Golden Egg." On one occasion Musella showed Stivaletti an article on insider trading with a cartoon depicting sources of inside information. Musella asked Stivaletti which one of the sources depicted was providing Stivaletti's information. Stivaletti replied that it was one of the them. Musella also paid Stivaletti his portion of the profits in cash as part of the arrangement and received advice from Stivaletti on how to avoid detection.

b. DeAngelis is Liable as a Tippee Because He Knew or Should Have Known that He was Trading on Misappropriated Non-Public Information.

A tippee who knows or is reckless in not knowing that he was trading on misappropriated non-public information violates Rule lOb-5. As this court (Haight, J) stated in granting summary judgment against two other defendants in this action, the issue is whether a tippee, wherever he stood in a chain of tippees, either knew or should have known that he was trading on improperly obtained non-public information." SEC V. Musella ("Musella II"), 678 F.Supp. 1060, 1062 (S.D.N.Y. 1988) (citing Musella I, 578 F.Supp..at 442). See also Dirks v.SEC, 463 U.S. at 660; Carpenter, 791 F.2d at 1032, 1034; SEC v.Vaskevitch, 657 F.Supp. 312, 314 (S.D.N.Y. 1987). [4]

The testimony elicited at trial together with the documentary evidence before the Court establish by a preponderance of the evidence that Musella relayed the stolen, non-public information from Sullivan & Cromwell to DeAngelis and that DeAngelis, in turn, knew or should have

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[4] The misappropriation theory of liability does not require a showing of a benefit to the tipper; nevertheless, the tippers here benefitted from their actions. Ihne clearly received a benefit from disclosing the non-public information because he received a share of the profits. Musella's tipping to DeAngelis was a gift to his longtime friend. See Dirks v. SEC, 463 U.S. at 663-664 ("[t]he elements of fiduciary duty, and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.")

known that he was trading on stolen, non-public information.[5] The Court is mindful that the SEC's evidence is largely circumstantial and is thus not without some degree of uncertainty; however, several factors give the Court confidence that it has drawn a proper inference from the record evidence. See Herman & MacLean v. Huddleston, 459 U.S. 375, 390, 391 n.30 (1983) ("proof of scienter required in [securities] fraud cases is often a matter of inference from circumstantial evidence. If anything, the difficulty of proving the defendant's state of mind supports a lower standard of proof (than by a preponderance of the evidence] .

First, DeAngelis' trading paralleled Musella's trading and always occurred shortly after Musella received the stolen information from Stivaletti. DeAngelis bought Marathon Oil just before the close of the market on the same day that Musella received the inside information from Stivaletti and made his ownMarathon purchases. DeAngelis not only purchased Marathon options but purchased one of the two specific series of options that Stivaletti told Musella to buy. DeAngelis next purchased Penn Central stock a few days after Musella made, his own purchases of stock on Stivaletti's instructions to purchase stock. Finally, DeAngelis began purchasing Signode the same day Stivaletti telephoned Musella from Hong Kong and told Musella that there was going to be a tender offer for Signode. Although Musella did not begin to purchase Signode until a few days after DeAngelis because Stivaletti had told Musella to wait until he returned from Hong Kong, Musella and DeAngelis spoke on the day DeAngelis bought Signode.

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5 Even if Musella never expressly told DeAngelis what the source of his information was, the success of Musella's information and its unlikely source (Musella) at a minimum put DeAngelis on notice to question the origin of the information. As previously held in this case, conscious avoidance of the source of confidential information in the context of insider trading does not defeat scienter. Musella II, 678 F.Supp.at 1063.

Second, the amounts involved and the financing of the trades suggest that DeAngelis confidence that these investments would "pan out" quickly was unusually high, and thus suggestive of insider trading. DeAngelis' investments in these stocks were unusually large in light of his previous trading history. DeAngelis' purchase of $64,000 of Marathon options was his first options purchase in over three years and over twice as large as his previous two options transactions. DeAngelis did not even complain to his broker when he learned soon after he had placed the order that the cost of the options was $20,000 - $30,000 more than his broker had estimated. His purchase of $120,742.44 of Penn Central stock was also very large. His purchase of $518,868.33 of Signode stock was by far the largest securities transaction of his life. In order to finance this trading, DeAngelis was able to borrow substantial amounts of funds from DeAngelis Jewelers, a business in which he had no financial interest.

Third, DeAngelis' testimony concerning his discussions with Musella about Marathon, Penn Central, and Signode and his reasons for his purchases of these stocks are not credible. DeAngelis told the Court that he purchased Marathon in part because he had read articles in foreign newspapers and in an Australian publication. He was unable to produce these articles or to recall any of the details about these articles at trial. In fact, Stivaletti told Musella about the pending takeover of Marathon on October 29, 1981, and both Musella and DeAngelis made enormous purchases before the close of the market that day and just before the public announcement the next day of the takeover.

DeAngelis' testimony that he bought Marathon because he had made money on Penn Central and because he knew the government would take his profit in taxes is also not believable and is inconsistent with the facts. Tr. at 267. DeAngelis actually purchased Penn Central after he purchased Marathon. Tr. at 162-163; PX 4 (DeAngelis' Response to Request to Admit) . Moreover, his profits on the Penn Central transaction were only $4,661.33 while the purchase price on the Marathon options was $64,217.34. Id.

The explanation DeAngelis offers for purchasing Penn Central stock is not credible and is contrary to the facts. He testified that he purchased Penn Central in November of 1981 because he believed that the government was going to subsidize the railroad and because of the great value of the railroad's land holdings that could be sold at a profit. However, according to Moody's Industrial Manual 1982, a standard reference for investors, Penn Central had conveyed its entire railroad holdings to Conrail in 1976 -- five years before DeAngelis purchased the stock -- and had also sold all of its real estate holdings in the late 1970's. Tr. at 230-233.

DeAngelis further asks the Court to believe that he invested half a million dollars in Signode based on an article he read in a Teamsters booklet and that it was he who bought Signode to the attention of Musella. The Court finds this testimony beyond credulity given that DeAngelis is unable to produce this publication and began purchasing Signode on the very day that Stivaletti telephoned Musella from Hong Kong to tell him that Signode was going to be the subject of a tender offer.

Fourth, John Malizia, the son of a close friend of DeAngelis, concluded that DeAngelis was trading on information not available to the general public. Malizia testified that he thought that DeAngelis was getting his information from "people that knew that something about what was going on with the particular instruments . . . someone that did know what was happening." Tr. at 421. Malizia had so much confidence in the accuracy of DeAngelis' "strong[] recommendation" to buy Signode that despite never having heard of Signode, he purchased $123,621.43 of Signode stock with funds borrowed in part from his family and friends. Id. at 419.

Fifth, DeAngelis' explanation that he and Musella discussed these stocks as two investors also suggests that he manufactured his explanations for his purchases. Musella, who had never made a securities purchase before purchasing Garfinckel in August of 1981, reported income for 1979 and 1980 of $6,642 and $4,361, respectively, and listed his

occupation as "beautician" and owner of the "Swirl & Curl" beauty salon in Brooklyn. DeAngelis testified, however, that he and Musella began discussing the stock market in 1977 or 1978.

Sixth, the Court does not credit DeAngelis' testimony that he did not know that Gus Drakos was Musella's broker when DeAngelis and his wife opened an account with Drakos. DeAngelis was unable to offer any credible explanation to the Court how it was that out of the thousands of Merrill Lynch brokers in New York, both he and Musella decided to use Gus Drakos in Cedarhurst, New York. DeAngelis' claim that he did not know that Drakos was Musella's broker is also belied by DeAngelis' observation that

> [i]f we suspected that Dominick (Musella) had inside information and we wanted to follow him, inasmuch as Drakos knew Richard (Stolfi - DeAngelis', colleague at the Teamsters office), all we had to do was find out what he bought and follow him. We didn't need Dominick to tell us anything, if that's what we wanted to do . . . . All we had to do was say, Rich [Stolfi], call up the guy you recommended, find out what he's [Musella's] doing and just follow him.

Tr. at 378-379. DeAngelis thus asks the Court to believe that he knew that Stolfi recommended a broker (Drakos) to Musella (his friend fo over twenty years and the person with whom he "discussed everything ... that two people can discuss" including the stock market) and that he also used Drakos as a broker, but it was not until "reading this case" that he realized that he and Musella did business with the same broker. The Court finds this testimony incredible.

Finally, DeAngelis denied even knowing Musella -- his friend for over twenty years with whom he admitted at trial that he discussed Marathon before purchasing it -- when SEC investigator Edward Harrington telephoned DeAngelis shortly after his large purchases of Marathon options. This false

exculpatory statement evidences consciousness of guilt and has independent probative value of scienter. See United States v. DiStefano, 555 F.2d 1094, 1104 (2d Cir. 1977); United States v. Johnson, 513 F.2d 819, 824 (2d Cir. 1975).

C. DeAngelis Traded on Material Information.

The information Musella gave DeAngelis regarding the potential tender offers and acquisitions was clearly material in that there was "a substantial likelihood that, under all the circumstances, the omitted fact[s] would have assumed actual significance in the deliberations of the reasonable shareholder." TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). See also Basic, Inc. v. Levinson, 108 S.Ct. 978,, 983 (1988) (expressly adopting the TSC Industries standard of materiality for Section 10 (b) and Rule 10b-5 violations). A reasonable investor would unquestionably regard the information DeAngelis received about Marathon, Penn Central, and Signode as significantly altering the "total mix" of information available in the market place. Basic v. Levinson, 108 S.Ct. at 983. Moreover, news of an impending transaction that is expected to increase the value of a security is especially likely to affect an investor's decision to buy, hold, or sell stock. See, e.g., SEC v. Shapiro, 494 F.2d 1301 (2d Cir. 1974) ; SEC v. Materia, CCH Sec. L. Rep. para. 99, 583 (S.D.N.Y. 1983); aff'd, 745 F.2d 197 (2d Cir. 1984); Musella I, 578 F.Supp. at 443 ("there is no question that the information allegedly tipped to the (defendants) by Alan Ihne was material ....")

The Court therefore concludes that DeAngelis is liable under Section 10(b) and Rule 10b-5 because he traded on information that he knew or should have known was non-public material information stolen from an inside source.

2. DeAngelis Violated, Section 14 (e) of the Exchange Act and Rule 14e-3.

Section 14(a) of the Securities Exchange Act of 1934, 15

U.S.C. SS 78n (e) , authorizes the SEC, with respect to tender offers to "define and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative." [6]

Rule 14e-3, promulgated by the SEC in 1980, established a "disclose or abstain from trading" duty for any person who is in possession of material information that relates to another person's tender offer, which information he knows or has reason to know is nonpublic and was acquired, directly or indirectly, from the bidder or the issuer of the securities subject to the tender offer.[7] As long as the alleged wrong

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6. Section 14(e), provides in full:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitations for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

7 Rule 14e-3 provides in relevant part:

(a) If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14 (e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has

relates directly to a tender offer, it is not necessary that the tender offer have commenced or that it even take place for liability to attach under Rule 14e-3. O'Connor & Assoc. v. Dean Witter Reynolds, Inc., 529 F.Supp. 1179, 1192 (S.D.N.Y. 1981). See also United States v. Chestman, 704 F.Supp. 451, 455-459 (S.D.N.Y. 1989) (citing the SEC's reasons for adopting the Rule).

DeAngelis violated Rule 14e-3 by his trades in Marathon options and Penn Central stock.[8] At the time that Ihne misappropriated the information from Sullivan & Cromwell and DeAngelis traded, Mobil and Esmark, the acquiring companies on whose behalf Sullivan & Cromwell were working (the "offering persons" within the meaning of the rule) had taken substantial steps to commence tender offers for Marathon and Penn Central, respectively. With respect to Marathon, Sullivan & Cromwell was retained on October 27, 1981 to provide legal advice concerning a proposed tender offer by Mobil Corporation, Mobil launched the tender offer

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reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from:

(1) [t]he offering person,

(2) [t]he issuer,of the securities sought or to be sought by such tender offer, or

(3) [a]ny officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.

8 The SEC did not include defendant's Signode trades in this claim.

for Marathon on October 31, 1981. Although Esmark eventually decided not to make a tender offer for Penn Central, Sullivan & Cromwell worked on the proposed acquisition of Penn Central during October of 1981.

For the reasons discussed supra with respect to DeAngelis' violation of Rule 10b-5., DeAngelis knew or should have known he was in possession of material, non-public information about pending tender offers. Material, inside information about a pending tender offer is likely to come from the acquiring company or someone acting on its behalf. Thus, even assuming that Musella did not know the specific source of the inside information he passed along to DeAngelis, DeAngelis was a sufficiently sophisticated investor to know or have reason to know that the source of Musella's information was either the "offering person" or someone acting on its behalf (here, Sullivan & Cromwell).[9] Therefore, DeAngelis' trades in Marathon options and Penn Central stock violated Section 14(e) and Rule 14e-3.

3. Injunctive Relief Appropriate and Necessary.

Section 21 (d) of the Exchange Act, 15 U.S.C. § 78u(d) (1982), empowers the SEC to seek a "temporary or permanent injunction" against "any person [who] is engaged or is about to engage in acts or practices constituting a violation" of the securities law. The commission need only show a reasonable likelihood that the securities violations will be repeated. Materia, 745 F.2d at 200; SEC v. Manor Nursing

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9 Rule 14e-3 also applies where the source of the inside information was the issuer of the target's securities or someone acting on the issuer's behalf. Rule 14e-3(a)(2). Thus, because he knew or should have known that he had inside information about proposed tender offers, DeAngelis necessarily must have known that the source of his information was either the acquiring company or the target company, or someone acting on behalf of one of those companies.

Centers, Inc., 458 F.2d 1082, 1102 (2d Cir. 1972). Fraudulent past conduct can support an inference of a reasonable expectation of continued violations. Manor Nursing Centers, Inc. 458 F.2d at 1100. Moreover, a court may consider additional factors bearing on the likelihood of future violations, including the degree of scienter involved, lack of remorse, attempts to mislead the SEC, as well as opportunities to repeat the prohibited conduct. SEC v.Tome, 833 F.2d 1086, 1095 (2d Cir. 1987), cert. denied sub nom. Lombardfin SPA v. SEC, 108 S.Ct. 1751 (1988).

In this case, the Court finds a compelling need for an injunction. DeAngelis' violations were knowing violations that extended over a long period of time and involved large sums of money. His continuation of his illegal trading after the SEC questioned him about his Marathon trades and his false statements to SEC Investigator Harrington show his willingness to violate the law. Moreover, DeAngelis has shown no remorse for his conduct. The manufactured and incredible explanations DeAngelis gave this Court for his trading demonstrate his continued lack of remorse and willingness to shirk responsibility for his illegal conduct.

Therefore, in light of the defendant's past violations, the degree of scienter involved, the apparent lack of remorse of the defendant, and the opportunity for future violations, the Court permanently enjoins DeAngelis from violating Section 10(b) and 14(e) of the Exchange Act and Rules lOb-5 and 14e-3.

4. Disgorgment and Prejudgment Interest is Appropriate.

Courts have authority to order disgorgement of insider trading profits in a SEC enforcement action. SEC v.Tome, 833 F.2d at 1096; SEC v. Materia 745 F.2d at 201; SEC v. Texas Gulf Sulphur Co. 446 F.2d 1301, 1307-1308 (2d Cir); cert. denied, 404 U.S. 1005 (1971). By prohibiting inside traders from profiting from their wrongdoing, disgorgement facilitates enforcement of the federal securities laws. SEC v. Tome, 833 F.2d at 1096.

Prejudgment interest on damages awarded pursuant to a violation of the federal securities laws is a matter of judicial discretion. Rolf v. Blyth, Eastman Dillon & Co. 637 F.2d 77, 86 (2d Cir. 1980); Norte & Co. v. Huffines, 416 F.2d 1189, 1191 (2d Cir. 1969), cert. denied sub nom, Muscat v. Norte & Co., 397 U.S. 989 (1970); Quintel Corp. v. Citibank, N.A., 606 F.Supp. 898, 914 (S.D.N.Y. 1985). The personal wrongdoing of a defendant should be considered in determining that an award of interest is in accord with doctrines of fundamental fairness. Norte Co., 416 F.2d at 1191; SEC v. Tome, 638 F.Supp. 638, 639 (S.D.N.Y. 1986), Affd. 833 F.2d 1086 (2d Cir. 1987). In the context of Section 10(b) and Rule lOb-5 actions, proof of scienter is sufficient to justify an award of prejudgment interest. See Rolf v. Blyth, 637 F.2d at 87.

A district court sitting in New York may use the rate of interest used to calculate prejudgment interest under New York law in calculating prejudgment interest in federal securities law cases. Quintel Corp. v. Citibank, 606 F.Supp. at 898. Under New York law, prejudgment interest is calculated at a simple rate of 9% for all claims arising after June 25, 1981. N.Y. C.P.L.R. § 5004 (McKinney 1988); see Quintel Corp. v. Citibank, 606 F.Supp.at 915.

Accordingly, the Court orders DeAngelis to disgorge all profits from his illegal transactions in the securities of Penn Central, Marathon Oil, and Signode, plus simple interest at a rate of nine (9) percent per annum on the profits from transactions in the securities of the mentioned companies, calculated from the date the defendant fully liquidated his positions in the securities.

CONCLUSION

For the reasons stated above, the Court finds in favor of the plaintiff on all claims. Defendant is permanently enjoined from future violations of § 10(b) and § 14(e) of the Securities Exchange Act of 1934 and rules lOb-5 and 14e-3 promulgated thereunder. Defendant is further ordered to disgorge all profits

from the aforementioned illegal_transactions plus simple interest at a rate of nine (9) percent per annum.

Counsel for the SEC is directed to submit to the Court on ten (10) days notice a proposed order in accordance with-this opinion.

SO ORDERED.

DATED: New York, New York
August 8, 1989

s/
Kimba M. Wood
United States District Judge

SUPREME COURT, U.S.
FILED
AUG 16 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. 89-1859 (2)

In the Supreme Court of the United States

OCTOBER TERM, 1990

ALBERT J. DEANGELIS, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioner, a tippee who purchased securities while in possession of material, nonpublic misappropriated information, acted with the requisite scienter or other culpability to establish a violation of Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78n(e), and Rules 10b-5 and 14e-3 thereunder, 17 C.F.R. 240.10b-5 and 240.14e-3.

2. Whether the district court abused its discretion in permanently enjoining petitioner from future securities law violations, ordering the disgorgement of his insider trading profits, and awarding prejudgment interest.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	7
Conclusion	13

TABLE OF AUTHORITIES

Cases:

Bateman Eichler, Hill Richards, Inc. v. *Berner*, 472 U.S. 299 (1985)	11
Berenyi v. *Immigration Director*, 385 U.S. 630 (1967)	7
Chiarella v. *United States*, 445 U.S. 222 (1980)	10
Dirks v. *SEC*, 463 U.S. 646 (1983)	8, 11
Herman & MacLean v. *Huddleston*, 459 U.S. 375 (1983)	8
Rolf v. *Blyth, Eastman Dillion & Co.*, 637 F.2d 77 (2d Cir. 1980)	13
SEC v. *Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984)	4
SEC v. *Musella*, 678 F. Supp. 1060 (S.D.N.Y. 1988)	4, 8
SEC v. *Switzer*, 590 F. Supp. 756 (W.D. Okla. 1984)	11
SEC v. *Tome*, 833 F.2d 1086 (2d Cir. 1987), cert. denied, 486 U.S. 1014 (1988)	13
United States v. *Chestman*, 903 F.2d 75 (2d Cir. 1990)	10, 12
United States v. *Doe*, 465 U.S. 605 (1984)	7
United States v. *Lanza*, 790 F.2d 1015 (2d Cir.), cert. denied, 479 U.S. 861 (1986)	8

Cases—Continued: Page

United States v. *Reliable Transfer Co.*, 421 U.S. 397 (1975) 7

United States v. *Werner*, 160 F.2d 438 (2d Cir. 1947) 10

Constitution, statutes and regulations:

U.S. Const. Amend. V 4

Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.*:

§ 10(b), 15 U.S.C. 78j(b) 4, 5, 7

§ 14(e), 15 U.S.C. 78n(e) 4, 6, 7

17 C.F.R.:

Section 240.10b-5 ..... 4, 5, 7, 8, 9

Section 240.14e-3 ..... 4, 6, 7, 12

Section 240.14e-3(a) 12

Miscellaneous:

2 W. LaFave & A. Scott, *Substantive Criminal Law* (1986) 10

In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 89-1859

ALBERT J. DEANGELIS, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The order of the court of appeals (Pet. App. 1a-2a) affirming the judgment of the district court is unreported, but the judgment is noted at 898 F.2d 138. The opinion of the district court (Pet. App. 3a-29a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on February 22, 1990. The petition for a writ of certiorari was filed on May 23, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. In the early 1980s, Alan Ihne was employed as the manager of office services at the Wall Street law firm of Sullivan & Cromwell. During that time, Sullivan & Cromwell rendered confidential legal advice to certain clients concerning anticipated extraordinary corporate transactions, including tender offers. Ihne, in breach of his fiduciary duties, repeatedly misappropriated information from Sullivan & Cromwell and its clients concerning these transactions and improperly shared that information with a friend, Joseph Palomba, and the friend's stockbroker, James Stivaletti. Those three conspired to profit from securities trading based on Ihne's stolen information. Pet. App. 4a, 17a.

In order to avoid detection, Stivaletti recruited Dominick Musella, the brother of a college classmate, to make securities trades for the group using the stolen information. Musella was the owner of the "Swirl & Curl" beauty salon in Brooklyn, New York. Stivaletti agreed to provide Musella with the names of the securities to be purchased in return for a share of the profits derived by Musella from trading on the information. Thereafter, Ihne would misappropriate information from his law firm, and Stivaletti would call Musella with directions on which securities to purchase. Stivaletti advised Musella to spread his trading among different accounts and, if possible, in accounts under different names. On several occasions, Musella met with Stivaletti in Musella's automobile in front of a diner late at night to discuss their arrangement. During one such meeting, Musella paid Stivaletti a share of the profits by handing him an envelope containing $18,000 in cash. Pet. App. 5a-6a, 11a-12a.

Although Musella pressed Stivaletti to identify the source of his information, Stivaletti refused to do so. Thereafter, Musella began to refer to the source as "The

Goose that Laid the Golden Egg." At one of their clandestine meetings, however, Musella showed Stivaletti a magazine article about illegal insider trading which described different sorts of persons (including lawyers, secretaries, and printers) who could have access to inside information. The article also contained a cartoon depicting the various sources of illegally obtained confidential information. Stivaletti, referring to the cartoon, told Musella that his source was "one of those." Pet. App. 5a-6a, 11a-12a; SEC C.A. Br. 8.

b. Petitioner, the President of Local 875, International Brotherhood of Teamsters, was a close friend of Musella's for over 20 years. The two spoke at least two or three times a week, "discuss[ing] everything * * * that two people can discuss." Shortly after Musella had made his first profitable securities purchase based on Stivaletti's information, Musella began to share certain of Stivaletti's tips with petitioner. Petitioner then traded in the stock or options of three companies based on information obtained from Musella, reaping substantial profits.[1] As to one com-

[1] In particular, on October 29, 1981, petitioner purchased 120 call options on Marathon Oil Company stock and sold them within two weeks, after the announcement of a tender offer for Marathon, for a profit of $268,513. In November 1981, petitioner purchased 3,000 shares of Penn Central Corporation stock and sold them within one week for a profit of $4,661. In February 1982, petitioner purchased 12,700 shares of Signode Corporation stock (investing $518,868) and sold the shares in early March 1982 for a profit of $89,617. In the Marathon transaction, Sullivan & Cromwell represented the investment banker for the tender offeror; Ihne provided stolen information about the upcoming transaction to Stivaletti, who relayed instructions to Musella to purchase call options. Petitioner purchased call options that same day. Similarly, Sullivan & Cromwell represented the investment banker for a potential bidder for Penn Central; Ihne again misappropriated the information and informed Stivaletti, who in turn told Musella to buy Penn Central shares. Petitioner bought Penn Central shares a few days later. Finally, Sullivan & Cromwell represented the

pany, Signode Corporation, petitioner strongly recommended to the son of a close friend that he purchase the stock "because * * * it was a possible takeover possibility." The son, who was a sophisticated investor, concluded that petitioner's information was confidential and came from "people that knew something about what was going on." Pet. App. 10a, 12a; SEC C.A. Br. 7 n.4, 9, 12 & n.8.

Shortly after purchasing a significant number of call options on Marathon Oil Company stock based on discussions with Musella, petitioner was contacted by a Securities and Exchange Commission (Commission) investigator looking into suspicious trading in Marathon. In response to a direct inquiry, petitioner falsely denied knowing Musella. Petitioner was later subpoenaed to appear before the Commission in an investigation relating to Marathon, but he invoked his Fifth Amendment privilege and refused to testify. Pet. App. 13a.

2. In a civil action brought by the Commission, the district court held that petitioner's trading violated Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78n(e), and Rules 10b-5 and 14e-3 thereunder, 17 C.F.R. 240.10b-5 and 240.14e-3.[2] Prior to trial, the Commission and petitioner stipulated

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investment banker in a management buy-out of Signode; Ihne's information about the proposed transaction was communicated to Stivaletti who again communicated with Musella. Petitioner began purchasing Signode that same day. Pet. App. 6a-10a; SEC C.A. Br. 9-13.

[2] The Commission's amended complaint alleged violations by 15 defendants in connection with the information stolen by Ihne. By the time of his trial, petitioner was the only remaining defendant. The other defendants (apart from Musella who died in 1984) either consented to judgments or had summary judgments entered against them. See *SEC* v. *Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984) (entering preliminary injunction against certain defendants); *SEC* v. *Musella*, 678 F. Supp. 1060 (S.D.N.Y. 1988) (entering summary judgment against certain other defendants); SEC C.A. Br. 15 n.12.

that Ihne had stolen confidential information from Sullivan & Cromwell; that Ihne shared the stolen information with Palomba and Stivaletti; that the three had agreed to trade on the information and split profits; that Musella and petitioner were close personal friends who spoke to each other frequently; and that Musella and petitioner made profits by trading in stock or options of Marathon, Penn Central, and Signode. SEC C.A. Br. 15-16.

Based on the stipulated facts and the evidence at trial, the district court found that Ihne had breached a duty of trust and confidence he owed his law firm and its clients by stealing confidential information; that the information was material; that Ihne gave the information to Stivaletti, who, in turn, enlisted Musella and directed him to make purchases based on Ihne's misappropriated information; that Musella transmitted the misappropriated information to petitioner; and that petitioner had traded while in possession of such information. Pet. App. 16a-17, 23a.

The district court further concluded that petitioner had the requisite scienter to sustain liability under Section 10(b) and Rule 10b-5. Noting that those provisions are violated when a tippee "knows or is reckless in not knowing that he was trading on misappropriated non-public information," Pet. App. 18a, the court found that the evidence met that standard with respect to petitioner. The court initially found that petitioner's tipper, Musella, "knew that the information was illegally obtained from an inside source," even without knowing the source's name. In support of that conclusion, the court pointed to Musella's reference to the source as "The Goose that Laid the Golden Egg," the fact that he engaged in covert meetings with Stivaletti, and his payment of profits in cash. The court also relied on Musella's conversation with Stivaletti about the insider trading article and cartoon depicting various sources of information, in which Stivaletti ad-

mitted that his information came from one of the inside sources shown. *Id.* at 17a.

The court further found that "Musella relayed the stolen, non-public information from Sullivan & Cromwell to [petitioner] and that [petitioner], in turn, knew or should have known that he was trading on stolen, non-public information." Pet. App. 18a-19a.[3] This finding flowed from the correlation between petitioner's trading activity and Musella's receipt of information from Stivaletti, *id.* at 12a, 19a; the large amounts of money petitioner invested in these securities compared with his previous activities and his "confidence that these investments would 'pan out,' " *id.* at 20a; the implausibility and inconsistency of petitioner's explanations for his investments, which the court rejected as "inconsistent with the facts," "beyond credulity," and "manufactured," *id.* at 20a-21a; the fact that a person tipped by petitioner formed the view that petitioner's information was nonpublic and had been obtained from a knowledgeable source, *id.* at 21a; and the inference of consciousness of guilt arising from petitioner's lie to the Commission's investigator when asked if he knew Musella, *id.* at 22a-23a.

The court also concluded that petitioner violated Section 14(e) and Rule 14e-3 by purchasing Marathon options and Penn Central stock while in possession of nonpublic information concerning tender offers. Pet. App. 23a-26a. The court explained that in light of the evidence, petitioner "knew or should have known that he was in possession of material non-public information about pending tender of-

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[3] The court noted that "[e]ven if Musella never expressly told [petitioner] what the source of his information was, the success of Musella's information and its unlikely source (Musella) at a minimum put [petitioner] on notice to question the origin of the information." Such "conscious avoidance * * * does not defeat *scienter*." Pet. App. 19a n.5.

fers" that was obtained from a source covered by the rule. *Id.* at 26a.

Having found insider trading violations, and in light of the "degree of *scienter* involved," the district court permanently enjoined petitioner from violating Sections 10(b) and 14(e) and Rules 10b-5 and 14e-3; ordered him to disgorge his insider trading profits; and awarded prejudgment interest. Pet. App. 27a-28a.

3. The court of appeals affirmed the district court's decision in an unpublished, memorandum order "substantially for the reasons stated in [the district court's] thorough opinion." Pet. App. 2a.

ARGUMENT

1. Petitioner's principal contention (Pet. 8, 10-11) is that the evidence failed to show that he acted with the requisite scienter or other culpability to violate Rules 10b-5 and 14e-3 as a tippee. He argues that his conduct fell outside the reach of those provisions because he "did not know and did [not] have the ability to find out the source of the information, where the source was employed or the nature of the source's occupation or that the information was obtained via a violation of fiduciary duty to an employer." Pet. 10. Petitioner's argument essentially challenges the factual finding, endorsed by both courts below, that petitioner did know or have reason to know he had traded on misappropriated, nonpublic information.[4] Because that finding is correct, and does not conflict with any decision of this Court or with that of any other court of appeals, this Court's review is not warranted.

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[4] Such factual issues, in which two courts have concurred, warrant no review here. See *United States* v. *Doe*, 465 U.S. 605, 614 (1984); *United States* v. *Reliable Transfer Co.*, 421 U.S. 397, 401 n.2 (1975); *Berenyi* v. *Immigration Director*, 385 U.S. 630, 635 (1967).

a. As the district court noted, Rule 10b-5 is violated when a tippee "knows or is reckless in not knowing that he [is] trading on misappropriated non-public information." Pet. App. 18a. Cf. *Dirks* v. *SEC*, 463 U.S. 646, 660 (1983). This Court has recognized that circumstantial evidence will often be the only way to establish the defendant's scienter. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 390 n.30 (1983). In this case, the circumstantial evidence was sufficient to support the district court's finding that petitioner knew that the nonpublic information he received from Musella had been obtained unlawfully.[5]

Musella, petitioner's immediate tipper, was recruited by Stivaletti to participate in a clandestine securities trading scheme. Stivaletti met with Musella in parked cars late at night, accepted payments in large amounts of cash, and counseled Musella to spread his trades across many accounts, if possible in different names. Indeed, although he would not name his source to Musella, Stivaletti acknowledged to Musella that his source was one of the types of persons identified in a cartoon (in an article about insider

[5] The district court concluded that even if Musella had not informed petitioner of the specific details of his conversations or dealings with Stivaletti, petitioner was still aware that the origins of the information were suspect, given the accuracy of the information in identifying companies that were involved in extraordinary business transactions. Pet. App. 19a n.5. In view of the circumstances, petitioner's failure to make inquiries of Musella amounted at least to "conscious avoidance" of the truth—a showing long understood to satisfy even the demanding knowledge requirements applied in the criminal context. See, *e.g.*, *United States* v. *Lanza*, 790 F.2d 1015, 1021-1022 (2d Cir.), cert. denied, 479 U.S. 861 (1986). The same principles apply here. See *SEC* v. *Musella*, 678 F. Supp. at 1063 ("I cannot accept that conscious avoidance of knowledge defeats scienter in a stock fraud case, any more than it does in the typical *mens rea* criminal context. To hold otherwise would subvert the laws against fraudulent trading in securities.").

trading that Musella was reading) who had access to such information because of the persons' employment. Musella thus learned that the information was procured in a breach of duty, and his close relationship with petitioner as well as the nature of petitioner's trading supports the inference that petitioner learned the same information.[6] Indeed, petitioner confidently recommended to another individual the purchase of stock in Signode based on Musella's information, predicting that the company was "a possible takeover possibility." The recipient of that information was impressed that petitioner "was getting his information from 'people that knew something about what was going on with the particular instruments . . . someone that did know what was happening,' " based on nonpublic information. Pet. App. 10a. Against that background, the record amply supports the finding that petitioner's trading was knowingly based on information obtained via the breach of duty by one with access to sensitive corporate information.

Petitioner contends (Pet. 10) that he is immunized from liability under Rule 10b-5 because he did not know the actual employment relationship from which the nonpublic information was misappropriated. Such a position, if accepted, would frustrate the policies underlying the prohibition against trading on misappropriated information. For good reason, it is hornbook law that the recipients of stolen property are liable without specific knowledge of

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[6] Petitioner's willingness to commit large sums of money to purchase securities based on Musella's tips reflected petitioner's belief that the person from whom the information had been obtained had special and reliable access to such information. See Pet. App. 26a. And petitioner's attempt to deceive an SEC investigator by denying that he knew Musella supports the court's finding that petitioner was conscious that the information on which he traded was improperly obtained. *Id.* at 22a-23a.

the origins of the property. See *United States* v. *Werner*, 160 F.2d 438, 441 (2d Cir. 1947) (L. Hand, J.) ("The receivers of stolen goods almost never 'know' that they have been stolen, in the sense that they could testify to it in a court room."); 2 W. LaFave & A. Scott, *Substantive Criminal Law* § 8.10, at 428 (1986). A similar principle applies to petitioner's trading on stolen information, particularly because misappropriation of confidential information is a form of theft. See *Chiarella* v. *United States*, 445 U.S. 222, 245 (1980) (Burger, C.J., dissenting) ("Chiarella * * * misappropriated—stole to put it bluntly—valuable nonpublic information entrusted to him in the utmost confidence."). To adopt a contrary rule would create a safe harbor for a sophisticated insider trader with a network of well-connected friends; all the tippee would have to do is turn a blind eye to the details about the specific source of the information. Not only would such a requirement undermine enforcement of the securities laws, it would exonerate an individual like petitioner who had ample reason for knowing that his conduct was unlawful.[7]

[7] The Second Circuit recently reversed a conviction in a criminal insider trading case because, according to the court, there was "no evidence that [the tippee] knew that [the source] was breaching a confidential relationship by imparting the information to him." *United States* v. *Chestman*, 903 F.2d 75, 79 (2d Cir. 1990), petition for rehearing, with suggestion for rehearing en banc, pending, No. 89-1276. We disagree with *Chestman*'s implication that evidence must be introduced to establish that the tippee had knowledge of the specific confidential relationship that was breached. Regardless of any tension between *Chestman* and the result here, however, this Court's review of the issue would be premature. No other court of appeals has addressed the precise requirements for establishing tippee scienter, and the result in this case is correct. Moreover, the government has asked the Second Circuit to grant rehearing en banc in *Chestman* to clarify the principles applicable to proving tippee scienter under Rule 10b-5.

Contrary to petitioner's contention (Pet. 11), the result in this case does not conflict with this Court's decision in *Dirks* v. *SEC, supra*. That case stated that a tippee of nonpublic information by a corporate insider is not liable unless the insider's disclosure of information breaches a fiduciary duty, and the "tippee knows or should know that there has been a breach." *Dirks*, 463 U.S. at 660. In this case, the district court found that petitioner was aware of (or consciously avoided learning) the facts known to Musella, who did know of a breach of duty; hence, even assuming that *Dirks* fully applies in a misappropriation case, its standards were satisfied. In any event, *Dirks* does not hold that a tippee must know the specific details of the confidential relationship that was breached in obtaining the information.[8]

[8] In discussing the requisite knowledge for tippee liability the Court noted in *Dirks* that "[t]he issue in this case, however, is not whether [the tipper] or [the tippee] acted with scienter, but rather whether there was any deceptive or fraudulent conduct at all[.]" 463 U.S. at 663 n.23. Thus, *Dirks* cannot be read to require that a tippee be aware of the specifics of the tipper's improper acquisition or disclosure of nonpublic information. Nor does language discussing tippee scienter in *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 313 n.22 (1985), support such a requirement. That case was addressed to the quite different issue whether the doctrine of *in pari delicto* barred a tippee from recovering from his tipper under Rule 10b-5, not the circumstances under which tippees may be held liable under the rule.

Petitioner also gains no support from *SEC* v. *Switzer*, 590 F. Supp. 756 (W.D. Okla. 1984). Pet. 11-12. In that case, the court concluded that the tipper had not disclosed the information to the tippee for an "improper purpose" and, thus, an essential predicate for tippee liability was absent. 590 F. Supp. at 766. The court went on to find, on the particular facts, that the tippee did not know or have reason to know of any breach by an insider. *Ibid*. But the tippee in *Switzer* did not engage in a pattern of trading immediately before the announcement of extraordinary corporate transactions (as petitioner did here), make covert cash payments (as Musella did), or deceive a Commission investigator (as petitioner did).

b. Petitioner errs in contending (Pet. 10) that he could not be found liable under Rule 14e-3 because he "neither knew or had the ability to find out that the information was material, non-public information imparted by a proposed tender offeror or its agent." Rule 14e-3 provides that if a person is in possession of material information relating to a tender offer, "which information he knows or has reason to know" is nonpublic and was acquired, directly or indirectly, from the bidder, the target, or a person acting on either's behalf, he is forbidden to trade in the securities or options of the companies involved. 17 C.F.R. 240.14e-3(a). As the district court explained, petitioner was a "sufficiently sophisticated investor" to have understood that Musella's information was derived from a proscribed source relating to a tender offer. Petitioner knew or should have known that "he had inside information about proposed tenders offers," and, from the nature of that information, he "necessarily must have known that the source of his information was either the acquiring company or the target company, or someone acting on behalf of one of those companies." Pet. App. 26a.[9]

2. Petitioner's challenge to the relief granted by the district court need not detain the Court. Although included in the questions presented (Pet. i), the issue is discussed only briefly and cryptically in the petition, Pet. 12, and that discussion does not indicate why petitioner be-

[9] Petitioner raises no issue with respect to the validity of Rule 14e-3, an issue recently addressed by the Second Circuit in *United States* v. *Chestman, supra*. There, a splintered panel was unable to agree whether Rule 14e-3 requires a breach of a fiduciary duty as a precondition of liability, and, if it does not, whether the rule is valid. The government has requested the court of appeals to rehear *Chestman* en banc to resolve whether Rule 14e-3 is valid and whether it requires a breach of fiduciary duty. In any event, that issue is of no concern to petitioner because the information communicated to him was obtained in breach of a fiduciary duty. Pet. App. 16a-17a.

lieves the grant of relief was improper or provide any reason for this Court's review of that issue. The equitable relief granted by the district court was well within its discretion to remedy securities law violations. See, *e.g.*, *SEC* v. *Tome*, 833 F.2d 1086, 1096 (2d Cir. 1987) (injunction and disgorgement), cert. denied, 486 U.S. 1014 (1988); *Rolf* v. *Blyth, Eastman Dillon & Co.*, 637 F.2d 77, 86 (2d Cir. 1980) (prejudgment interest).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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AUGUST 1990

U.S. GOVERNMENT PRINTING OFFICE 1990—262 203/20067

(3)

No. 89-1859

Supreme Court, U.S.
FILED
SEP 7 1990
JOSEPH F. SPANIOL, JR.
CLERK

IN THE
Supreme Court of the United States
October Term, 1990

ALBERT J. DeANGELIS,

Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES i

PRELIMINARY STATEMENT 1

REASONS FOR GRANTING THE PETITION.

I. THE PETITION SHOULD BE GRANTED BECAUSE THIS CASE PRESENTS IMPORTANT ISSUES FOR THIS COURT'S REVIEW CONCERNING THE APPLICATION OF THE CIVIL ENFORCEMENT PROVISIONS OF THE FEDERAL SECURITIES LAWS, THE ORDER OF THE SECOND CIRCUIT CANNOT BE RECONCILED WITH RECENT DECISIONS BY THAT COURT OR WITH ESTABLISHED PRINCIPLES OF LAW APPLICABLE TO SUCH CASES. 2

CONCLUSION 9

TABLE OF AUTHORITIES

Cases:

Dirks v. SEC, 463 U.S. 646 (1983) 3, 5

SEC v. National Securities, Inc., et al., 393 U.S. 453 (1969) 3

Securities and Exchange Commission v. Unifund SAL and Tamanaco, Saudi and Gulf Investment Group, et al. (slp. opn. 2d Cir., decided August 3, 1990), 3, 6, 7

United States v. Robert Chestman, 903 F.2d 75 (2d Cir. 1990), petition for rehearing in banc granted, August 24, 1990 3, 5, 6, 7

Statutes and Rules:

15 U.S.C. 78(j)(b) 2, 3

15 U.S.C. 78(n) (e) 2, 4

Rule 10b-5, 17 C.F.R. 240.10b-5 2, 4, 5

Rule 14e-3, 17 C.F.R. 240.14e-3 2, 4, 5

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

PRELIMINARY STATEMENT

This brief is respectfully submitted on behalf of ALBERT DeANGELIS (DeANGELIS) in reply to the brief submitted by the Securities and Exchange Commission in opposition to the petition for a writ of certiorari. A Panel of the United States Court of Appeals for the Second Circuit summarily affirmed a

judgment entered against DeANGELIS by the United States District Court, Southern District of New York. The District Court's opinion consisted of its adoption, without change, of the proposed findings of fact and conclusions of law submitted by the Securities and Exchange Commission (the SEC).

The District Court (Hon. Kimba Wood) concluded that DeANGELIS was liable for violation of Section 10(b) and Section 14(e) of the Securities and Exchange Act, 15 U.S.C. 78(j)(b), 78 (n) (e), Rule 10b-5, 17 C.F.R. 240.10b-5, Rule 14e-3, 17 C.F.R. 240.14e-3 for trading in securities. Petitioner does not here challenge the findings of fact made by the District Court. Rather, petitioner respectfully contends that the facts as found by the District Court were insufficient to support the Court's finding of liability and that the lower Courts interpretation of the federal securities laws concerning "insider trading" expands the reach of the law well beyond its statutory basis.

REASONS FOR GRANTING THE PETITION.

I. THE PETITION SHOULD BE GRANTED BECAUSE THIS CASE PRESENTS IMPORTANT ISSUES FOR THIS COURT'S REVIEW CONCERNING THE APPLICATION OF THE CIVIL ENFORCEMENT PROVISIONS OF THE FEDERAL SECURITIES LAWS, THE ORDER OF THE SECOND CIRCUIT CANNOT BE RECONCILED WITH RECENT DECISIONS BY THAT COURT OR WITH ESTABLISHED PRINCIPLES OF LAW APPLICABLE TO SUCH CASES.

It is respectfully submitted that the petition should be granted because of the important issues presented as to the application of the enforcement provisions of the federal

securities laws. See *SEC v. National Securities, Inc., et al.*, 393 U.S. 453 (1969) (Petition for Certiorari granted because of importance of questions raised to administration of securities laws); *Dirks v. SEC*, 463 U.S. 646 (1983) (Petition for Certiorari granted in view of the importance to the SEC and to the securities industry of the questions presented). Further, it is submitted that the petition should be granted because the order in the DeANGELIS case by the Second Circuit cannot be reconciled with subsequent decisions by that same Court in *United States v. Robert Chestman*, 903 F.2d 75 (2d Cir. 1990), petition for rehearing in banc granted, August 24, 1990 and *Securities and Exchange Commission v. Unifund SAL and Tamanaco, Saudi and Gulf Investment Group, et al.* (slp. opn. 2d Cir., decided August 3, 1990), with respect to the issue of the burden placed on the SEC to establish a tippee's violation of the securities laws. The issues presented in this case are the same as those before the Second Circuit en banc in the *Chestman* case. However, only this Court's pronouncement on the important issue of the scope of the federal securities laws can assure uniformity in all of the Circuits.

While it is conceded that a conflict between two opinions in the same circuit on the same issue of law does not in and of itself justify this Court's review, it is submitted that the pre-eminent historical role of the Second Circuit in shaping the development of jurisprudence concerning the federal securities laws makes it most appropriate that the issues presented here be reviewed by this Court. The present petition provides this Court with the vehicle to review the scope of the enforcement provisions of the federal securities laws. Because of the broad criminal and civil sanctions which are implicated upon violation of these federal laws, it is submitted that uniform rules defining the standards of liability of persons trading in securities are essential.

The opinion of the District Court as upheld by the

summary order of the Second Circuit, imposes liability against DeANGELIS under the anti-fraud provisions of Rule 10-b(5) of the Securities and Exchange Act without proof of his scienter or knowledge on DeANGELIS' part that he was trading on misappropriated non-public information obtained by a twice removed tipper in breach of a fiduciary duty to his employer. In addition, the Court's opinions impose liability against DeANGELIS, under Rule 14(e) of the Securities and Exchange Act for trading in options without any showing that he knew or should have known that he was in possession of material, non-public information about pending tender offers imparted by the "offering person" or someone acting on his behalf.

The lower Courts expansive interpretation of the reach of the law to make a subsequent tippee liable where it was shown that he had no connection whatsoever with the primary tippee or of the primary tipper, did not know and did he have the ability to find out the source of the information, where the source was employed or the nature of the source's occupation or that the information was obtained via a violation of fiduciary duty to an employer, threatens the viability of the market by imposing an extraordinary and burdensome investigative duty upon persons wishing to trade in stocks or call options. In this case, DeANGELIS relied upon the speculative successes and the recommendations of his friend Musella and upon his own evaluation of public reports in reaching a decision to make security purchases in the three companies, Marathon, Penn Central and Signode. The record is devoid of any showing that DeANGELIS knew that the information was appropriated, non-public information obtained in breach of a fiduciary duty. Further, with respect to the call options in Marathon and Penn Central, DeANGELIS neither knew or had the ability to find out that the information was material, non-public information imparted by a proposed tender offeror or its agent.

In the case *sub judice* , DeANGELIS, not an insider and

owing no fiduciary duty to the corporations involved, was effectively held liable under the provisions of Section 10(b) and Rule 10b-5 because the District Court found he possessed non-public market information. In addition, the District Court premised liability under Section 14e-3 and Rule 14e-3 upon its conjecture that DeANGELIS had reason to know that tips concerning Marathon Oil and Penn Central call options were derived from the proposed tender offerer or its agent. Yet, the record shows with clarity that the tender offeror or its agent were entities and individuals whom DeANGELIS did not know, know of or have any connection with whatsoever. Premising liability upon a tippee equal to or as broad as that of the tipper is inconsistent with the provisions of the federal securities laws.

In *United States v. Chestman*, 903 F.2d 75 (2d Cir. 1990), petition for rehearing in banc granted August 24, 1990, the Court of Appeals, relying upon this Court decision in *Dirks v. S.E.C.*, 463 U.S. 646, 660 (1983), noted that for a tippee to be held liable under Section 10(b) and Rule 10b-5, three elements must be established. The first element is that the tipper held a fiduciary duty to the party from whom he obtained the information. The second element is that the tipper violated his fiduciary duty by appropriating material non-public information. The third element is that the tippee has knowledge of this breach of fiduciary duty by the tipper. In *Chestman,* a Second Circuit panel, comprised of Judges other than those summarily affirming the judgment against DeANGELIS, found that liability on this ground could not be sustained because:

> "The government can point to nothing in the record demonstrating actual or constructive knowledge on the part of Chestman that Keith Loeb was pledged to secrecy by Susan Loeb, who was pledged to secrecy by Shirley Witkin, who was pledged to secrecy by Ira Waldbaum.. Loeb testified that on direct examination that he could not recall describing the information as confidential, and there is no

evidence that he ever alluded to the source of the information. *** It is impossible to attribute knowledge of confidentiality to Chestman in view of the attenuated passage of the information and the absence of any showing that the information retained any kind of confidentiality in the hands of Keith Loeb."-Id. at 77.

Although the SEC in the present case could point to nothing in the record showing that DeANGELIS knew or should have known that Ihne owed a fiduciary duty to the law firm of Sullivan and Cromwell where he was employed and that he breached his fiduciary duty by misappropriating material non-public information, the Second Circuit summarily affirmed a finding of liability under Section 10(b) and Rule 10 (b) (5). As the record is undisputed that DeANGELIS neither knew, knew of or had the ability to find out the source upon which his friend Musella based his recommendations, it cannot be found that DeANGELIS knew that he was trading on material non-public information obtained from a twice removed tipper in breach of fiduciary duty. Indeed, the District Court did not find that DeANGELIS had actual or constructive knowledge of the source of the recommendations or that they involved a misappropriation in breach of the tipper's fiduciary duty to his employer. Rather, the District Court speculated that DeANGELIS should have known that the recommendations were obtained from such a source.

In *Securities and Exchange Commission v. Unifund Sal et al.*, (Slp. Opn., 2d Cir. August 3, 1990), yet another panel of the Court rejected such a speculative conclusion as the basis to uphold a broad based preliminary injunction against future violations based upon Section 10(b) and Rule 10(b) (5). The Court observed:

"An insider trading violation requires proof not only that the defendant traded on the basis of material nonpublic

> information but also that in doing so he knew or should have known that he was breaching a fiduciary duty.
>
> In this case, the Commission has not identified the person or entity alleged to have conveyed inside information to either appellant. It is therefore more difficult than in the typical tipping case to determine whether, even if appellants obtained inside information, they traded upon it in breach of a fiduciary duty that they knew or should have known existed. Though a tippee's duty to disclose or abstain is derivative from that of the insider's duty, we do not know from whom such a duty might derive in this case.

The Commission attempts to bridge this fundamental gap in its evidence with speculation. Even if we assume that it has sufficiently shown an adequate probability that Candid Peyer, Espirito Santo's broker at Raymond Jones, had material nonpublic information from an insider, we are then asked to infer the requisite relationship to Unifund and Tamanaco from wholly inadequate circumstances. ***The link to Unifund assumes that Peyer's information was conveyed to Raymond Jones, then to Bank Audi, then to Unifund, under circumstances where Unifund knew or should have known of a nondisclosure obligation. These assumptions are unsupported on this record." Slp. Opn. at 5893, 5894, citations omitted, footnote omitted).

It is submitted that in light of the panel opinions of the Second Circuit in *Chestman* and *Unifund*, re-affirming the requirement that the Government prove that the tippee obtained material non-pubic information from a tipper who violated his fiduciary duty, under circumstances where the tippee knew or should have known of the source and nature of the information, the summary order of the Second Circuit in the DeANGELIS case can only reasonably be viewed as an erroneous decision of the District Court which, as a result of its summary treatment by

the Second Circuit, was not reversed on appeal in conformity with the principles of law applicable to such "insider trading" cases.

It is submitted that this petition should be granted because this case presents issues involving the uniform application of the Securities and Exchange Act of 1934 and the Rules adopted by the Commissioner pursuant thereto and the standard of conduct of persons trading in securities. In addition, this case presents an important issue concerning the use of the Court's injunctive powers to enjoin future violations of law, where there is no indication that the legal remedies are likely to be ineffective in deterring or preventing future violations. Further, the petition should be granted here for there is a strong likelihood that the decision below will have a chilling effect on speculative market investment, which constitutes a substantial portion of the revenues received by the securities industry and provides needed impetus to the Nation's economy.

CONCLUSION

For the foregoing reasons, it is earnestly urged that the petition for a writ of certiorari to review the decision and order of the Second Circuit should be granted, along with such other and further relief awarded to petitioner as this Court may deem just and proper.

Dated: Brooklyn, New York
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